April 2021

Longleaf Partners Small-Cap Fund Commentary

1Q21

Longleaf Partners

Longleaf Partners Small Cap Fund added 11.74% in the quarter, which compared to the Russell 2000's 12.70% return. Almost every company in the portfolio was positive in the quarter, with no significant detractors. This quarter's top contributors were among last year's largest COVID laggards. Strong stock-specific performance drove positive returns, even as the Fund was underweight the banks and lower-quality companies that dominated the index's returns in a period when "traditional value" small-cap stocks rebounded in a meaningful way. Cash, which averaged 22% in the quarter (and is discussed in more detail below), more than accounted for the relative shortfall.

Since we are bottom-up business appraisers and long-term business owners, the most important driver of our long-term returns will always be stock selection. In a first quarter that saw a lot of macro focus on interest rates and retail stock trading mania, we saw strong stock-specific returns across the majority of the portfolio with no significant detractors. The Fund's five largest positions were the top performance drivers. Lumen outperformed telecom peers as fears about its near-term cash flow recede with its steady business mix improvement, yet it still trades at less than half of its private market value. CNX performed well on its way to $2/share of relatively low risk free cash flow (FCF), and the market has still yet to recognize how much more of its

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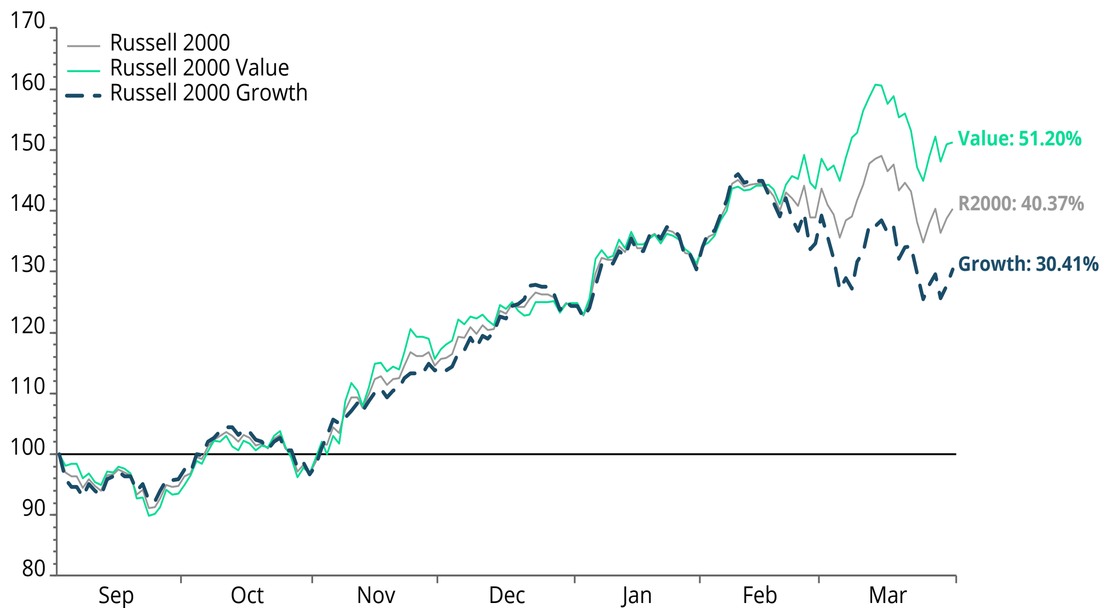
Average Annual Total Returns for the Longleaf Partners Small-Cap Fund (3/31/21): Since Inception (2/21/89): 10.76%, Ten Year: 10.40%, Five Year: 10.32%, One Year: 81.62%. Average Annual Total Returns for the Russell 2000 (3/31/21): Since Inception (2/21/89): 10.17%, Ten Year: 11.68%, Five Year: 16.35%, One Year: 94.85%.

Returns reflect reinvested capital gains and dividends but not the deduction of taxes an investor would pay on distributions or share redemptions. Performance data quoted represents past performance. Past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the fund may be lower or higher than the performance quoted. Performance data current to the most recent month end may be obtained by visiting southeasternasset.com. ***As reported in the Prospectus dated May 1, 2020, the total expense ratios for the Longleaf Partners Small-Cap Fund is 0.93%.***

earnings before interest, taxes, depreciation and amortization (EBITDA) turns into FCF than peers. Mattel has a path to $1.50/share of FCF in less than three years, before finally monetizing its trove of intellectual property (IP). Newer holdings like Liberty Braves and Everest Re have been quick contributors and we believe are set up well for future value growth.

We have written about value being out of favor and underperforming relative to growth extensively over the last decade. Last year, the relative gap between the two strategies reached historic levels, with value suffering its worst performance run in at least two centuries, as we wrote about last December in a paper titled Why We Believe Value Will Work Again. We wrote then that it was early days but that “the market might already be turning towards value.” The chart below shows that value’s relative strong outperformance has continued in the first quarter.



Source: FactSet

While we believe that we are just at the beginning of a long-term rebound of fundamentals mattering again, we understand some might ask: 1) if the “shift to value” has already played out or is yet another head fake; and 2) if our higher-than-average cash is evidence that the easy money has been made or we are not participating

enough in this market rally. On 1), the relative multiple math for our portfolio vs. the market from the WWB piece still holds, as shown in the chart below, even after this quarter's strong performance. We think it is especially important to point out that a lot of what is traditionally described as "value" is no longer as attractive as it once was, and the gap between what we own and the Russell 2000 Value is much wider than usual. As evidence, the non-Healthcare/Information Technology part of the Russell 2000 is now trading above a 21x multiple on the 12/31/19 2021 EPS estimates from before COVID, even though earnings power has since been impaired and this group usually averages a mid-high teens multiple.

Implied Returns Based on Various P/E Assumptions

	2022 P/E		P/E Change	Performance from P/E Change
	Current	Assumption		
Russell 2000	17.83	16.70	-1.1	-6%
Russell 2000 Growth	24.06	20.00	-4.1	-17%
Russell 2000 Value	14.84	14.29	-0.6	-4%
Longleaf Partners Small-Cap Fund	11.18	14.29	+3.1	+28%

Source: FactSet. Actual investment results and performance are not guaranteed

Our values and free cash flow per share estimates have grown. Despite this, there are days when various parts of the market move in lockstep so that it feels like all the ETF money sloshing from theme to theme is all that matters. We disagree. There is a big difference between our portfolio's actual valuation floor supported by both reasonable discounted cash flow models (DCFs) and strategic/financial buyers willing to pay at or above our appraisals vs. the higher-flying stocks in the market where that real-life bid for the full company doesn't exist. The depths of COVID took away that bidder safety net for a while given the lack of on-the-ground due diligence. As things get back to normal, there have been plenty of deal announcements in the market over the last few months. This bodes well for our portfolio, which has historically benefitted from buyouts.

On the other hand, the wild IPO and SPAC speculation that we discussed in our 2Q and 4Q 2020 letters has only intensified. Joining the party, we now have NFTs bringing the 1990s Beanie Baby energy, where falsely perceived scarcity creates thousands and

then millions of dollars out of thin air, thus eventually also creating too much supply and sowing the seeds of a downfall. We take comfort knowing this short-term frenzy is a necessary step towards more rationality coming our way sooner rather than later, and we began to see cracks emerge in the SPAC world as the quarter drew to a close. Usually at a market turn, you see the weakest parts of the previous run-up get shaken out first, and that might already be happening for some SPAC participants. While short-term SPAC valuations are in silly territory, there is a great long-term benefit to so many companies and management teams coming back into the public realm, as it ultimately increases the investable universe of opportunities for long-term investors like us.

On 2), our cash is never a top-down market call, but rather the residual of the bottom-up opportunity set. We would of course prefer to be fully or close-to-fully invested at all times as a result of finding compelling investment opportunities, but we remain disciplined in an overvalued market and have proven (with quarters like this one), that we can deliver solid absolute returns with less risk when we have a cash buffer. Our history has shown that our cash can turn into investments quickly. Over the last 15 years, we initiated multiple new investments in 59% of all quarters immediately following a quarter of 20% or higher cash.

While the Small Cap Fund has delivered absolute returns of 39% since 12/31/18, it might not have felt like it along the way, with COVID pain in the first half of 2020, bookended by higher-than-average cash weighing down relative returns in a strong up market pre-and post-March 2020. In the second half of last year, we had both an unusually high number of pre-qualified on-deck companies (six new qualifiers, plus in-process additions to underweight holdings like Empire State Realty Trust) and an unusually low number of those that we were able to fully execute on, with only partial new positions in Everest Re and Liberty Braves. While one extreme of March 2020 (when we were buying) made it feel hard to own ANY small cap stocks, the extreme of March 2021 after a historic run in the Russell 2000 over the last five months makes it feel bold NOT to own ALL the stocks. Now is the time to remain patient and stick to our investment discipline of reducing portfolio risk by selling fully-valued securities and waiting until new opportunities with an adequate margin of safety qualify, even if it means temporarily holding higher cash while we wait.

We have considered re-closing the Small Cap Fund given its elevated quarter end cash level, but for the moment we are choosing not to for multiple reasons: 1) our overall price to value (P/V) level is below 70%; 2) the portfolio's 2022 P/FCF multiple remains attractive in both absolute and relative terms, as detailed above; 3) our on-deck list remains solid and probably even better than this time last quarter, as we will detail below, and we still have not finished buying two new positions initiated this quarter; 4) we think that market conditions can change quickly and that we can quickly put the current cash balance to work. At $2 billion of assets under management to end the quarter, we are comfortably below the $2.5 billion limit we mentioned when we re-opened last year, and that $2.5 billion is itself a materially lower percentage of the Russell 2000 than it was then. Any new incremental cash received in the portfolio would likely go to sizing up current underweighted positions and ultimately to funding our next new qualifiers. We remain committed to doing what is right for existing, long-term holders of Longleaf Partners Small-Cap Fund, and we will update you if our thinking changes.

Contributors/Detractors

(Q1 Investment return; Q1 Fund contribution)

Lumen (40%, 3.33%), the global fiber company, was the top contributor. While COVID fallout still weighed on fourth quarter results, the company benefitted from positive business mix improvements. Early in the quarter, Lumen appreciated 38% in a few short days amidst the "Game Stop / Reddit" short cover phenomenon, and we trimmed the position on the price strength. After this short-term bounce, Lumen's stock price appreciated more steadily over the last six weeks of the quarter with improved results. Many of last year's worst-case fears have not materialized, and the outlook is improving for the core business. We continue to believe that the company has multiple ways within its control to both grow and realize value per share, and we have a 13D filed to allow us to discuss these options with the company. Lumen's board, which includes Southeastern-nominated Chairman Mike Glenn from FedEx and Director Hal Jones from Graham Holdings, is doing good work to realize Lumen's hidden value and return the business to FCF/share growth. Despite its appreciation, the stock trades at less than half of our appraisal.

CNX Resources (36%, 2.54%), the Appalachian natural gas company, was another top contributor. The company earned $85 million FCF in the fourth quarter and used the profits to pay down debt and repurchase shares at a 7% annualized pace. 2021 and 2022 production is hedged at solid prices, and the company has guided to a growing $1.90 per share FCF coupon in the near term. The stock trades under 8x FCF before adjusting for farther off undeveloped acreage and the company's pipeline infrastructure. CNX is the lowest-cost producer in the region and its PDP decline rate continues to improve, meaning it can maintain or grow future production without spending heavily. Encouragingly, CNX announced meaningful progress in its ESG initiatives in the quarter, including its commitment to transparent reporting through its adoption of Climate-Related Financial Disclosure (TCFD) and the Sustainability Accounting Standards Board (SASB) disclosure standards. We have engaged with CNX leadership on this topic over the last several years and have encouraged them to commit to these leading industry standard disclosure frameworks. Additionally, the company formed a dedicated working group focused on future emissions reduction and approved a performance measure program that ties executive compensation to meeting targeted methane emissions reduction thresholds over a three-year period.

Empire State Realty Trust (19%, 1.23%), the New York City property owner, also contributed to strong performance. Quarterly results were resilient, with occupancy remaining in the high-80s% in a challenging environment and Empire State Building observatory volumes slowly improving while gaining share from competing attractions. The company repurchased discounted shares at a 5% annualized pace. The stock still trades at a low multiple of earnings power and a 30%+ discount to our appraisal. CEO Tony Malkin shared his expectation that the depressed New York City market will recover in occupancy and pricing from 2022.

Realogy (15%, 1.03%), the residential real-estate brokerage franchisor, was also a strong contributor. Franchise fees increased 36% year-over-year (YOY). The company generated $2.22 of FCF in the fourth quarter alone, less than 7x the stock's price. The national single-family housing market remains very strong with big price increases helping to grow Realogy's fees. Realogy also grew its market share, a welcome reversal from 2020 losses. Realogy's title and mortgage sales have also increased substantially in recent months. While the company might trade in the short term with interest rate fluctuations, we believe its long-term outlook remains bright with value growth coming

from FCF allocated by great management that is aligned with shareholders, and by long-term home price appreciation combined with future increasing millennial home ownership. The end of the quarter also saw Realogy's competitor Compass come public in a somewhat disappointing IPO that still valued it at multiples of any comparable metric on which Realogy trades. We think some public company discipline for Compass leading to any attempted focus on FCF instead of revenue growth at all costs could be a good thing for Realogy.

Mattel (14%, 0.87%), the global toy company, also contributed to the Fund's positive returns. Fourth quarter sales grew 10%, with Barbie once again leading with an impressive 18% growth, American Girl up 9% due to direct-to-consumer strength, Hot Wheels up 12% and Infant/Toddler growing 7%. Margins also improved to increase EBITDA 53% year-over-year (YoY) during the company's all-important seasonal peak. CEO Ynon Kreiz's outlook for 2021-23 includes achievable targets of mid-single-digit revenue growth and continuously improving margins. Mattel's strategically important IP monetization has also developed well with no fewer than 25 media projects in the works. We expect significant contributions from these high-margin IP revenues over the next several years and do not think the market yet gives the company credit for the scale of this opportunity.

Portfolio Activity

We exited two businesses in the period: PotlatchDeltic and Formula One. In both cases, share price went above our appraised value, even though we continue to view the businesses and management teams highly and hope to have the opportunity to partner with them again. We have owned the assets at PotlatchDeltic successfully four times now in the last two decades and have great respect for the management team. Although Formula One was a new business for us, we have partnered with John Malone and Greg Maffei across multiple Liberty Media businesses and remain partnered with them at Liberty Braves. We trimmed an additional six holdings, taking advantage of price strength to manage position sizes at companies trading at a higher price-to-value.

We bought two new businesses, both of which remain undisclosed as we are still filling out the positions. One is a company that we know well and own in other portfolios and recently became cheap enough to become a new buy again. The second is a

healthcare company that is new to us, but where we have an aligned management team with a superior history of long-term value creation.

Our team has been hard at work evaluating new businesses across multiple sectors, including healthcare, consumer products and infrastructure. Our on-deck list remains better than we would expect for a market at this aggregate level, as new companies have moved on but some have moved off. There are not broad "themes" that are driving our new additions, but rather unique one-offs that come our way as we go down the list day by day. For example, we are working on two misunderstood internet/software companies that are being temporarily punished due to a combination of industry cyclicality and short-term, company-specific overhangs; we have found two real estate services companies that trade at discounts to potentially inferior peers; we are watching closely a media/entertainment company that we have previously owned. We can see multiple ways to have a similarly productive second quarter and rest of the year on new name generation. We also have several existing holdings closer to buys than sales at today's portfolio weights.

Outlook

We are excited about the specific company opportunities in our portfolio and on our on deck list, but we would also highlight a few additional potential sources for tomorrow's "value stocks." While more money into index funds or thematic ETFs can lift a lot of boats in good times, there will inevitably be bad times when all these move down together, leading to some high-quality companies within this group becoming misunderstood, and then we will get a chance to own them. That statement might apply more to some of the higher-flying parts of the market, so we would also point to some of the more boring, consumer product parts of the market with hope. The thirst for perceived safety via low-volatility grew over the last several years in conjunction with lower interest rates / higher multiples, amplified by a one-time COVID bump that helped that group further. We have owned many high-quality consumer goods companies before, but we expect a tougher near-term outlook for these "places to hide." We expect this will eventually translate into more opportunities for long-term value investors like us at better multiples.

The best way we can thank our clients for their long-term partnership is with good absolute returns, so we are glad to start the year off as we have. We do not believe this

is a blip. Value has outperformed growth for 85%+ of rolling 10-year periods through recorded history. The data would support that we are more likely than not just getting started after a longer than usual rough period. We also like how our unique portfolio is positioned vs. an average active value manager or ETF. We do not own either extreme of 1) opaque, undifferentiated bank stocks or 2) "compounders" that are great qualitatively but just are not undervalued and therefore have minimal or no margin of safety. Our carefully selected portfolio has much more room to grow, and our cash holdings will provide a buffer vs. overvalued markets and then turn into our next great qualifiers.

See following page for important disclosures.

Before investing in any Longleaf Partners Fund, you should carefully consider the Fund's investment objectives, risks, charges, and expenses. For a current Prospectus and Summary Prospectus, which contain this and other important information, visit https://southeasternasset.com/account-resources. Please read the Prospectus and Summary Prospectus carefully before investing.

RISKS
The Longleaf Small-Cap Fund is subject to stock market risk, meaning stocks in the Fund may fluctuate in response to developments at individual companies or due to general market and economic conditions. Also, because the Fund generally invests in 15 to 25 companies, share value could fluctuate more than if a greater number of securities were held. Smaller company stocks may be more volatile with less financial resources than those of larger companies.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3,000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. The Russell 2000 Value index is drawn from the constituents of the Russell 2000 based on book-to-price (B/P) ratio. An index cannot be invested in directly.

EBITDA is a company's earnings before interest, taxes, depreciation and amortization.

Free Cash Flow (FCF) is a measure of a company's ability to generate the cash flow necessary to maintain operations. Generally, it is calculated as operating cash flow minus capital expenditures.

The price-to-free cash flow ratio (P/FCF) is a valuation method used to compare a company's current share price to its per-share free cash flow.

An IPO is an initial public offering, referring to the process of offering shares of a private corporation to the public in a new stock issuance.

Environmental, social, and governance (ESG) criteria are a set of standards for a company's operations that socially conscious investors use to screen potential investments.

Climate Related Financial Disclosure (TCFD) is a reference to The Task Force on Climate-Related Financial Disclosures, an organization established with the goal of developing a set of voluntary climate-related financial risk disclosures which can be adopted by companies so that those companies can inform investors and the public about the risks they face related to climate change.

The Sustainability Accounting Standards Board (SASB) is an independent nonprofit organization that sets standards to guide the disclosure of financially material sustainability information by companies to their investors.

P/V ("price to value") is a calculation that compares the prices of the stocks in a portfolio to Southeastern's appraisal of their intrinsic values. The ratio represents a single data point about a Fund and should not be construed as something more. P/V does not guarantee future results, and we caution investors not to give this calculation undue weight.

"Margin of Safety" is a reference to the difference between a stock's market price and Southeastern's calculated appraisal value. It is not a guarantee of investment performance or returns.

A SPAC is a special purpose acquisition company.

NFTs are non-fungible tokens. NFTs are cryptographic assets on blockchain with unique identification codes.

A 13D filing is generally required for any beneficial owner of more than 5% of any class of registered equity securities, and who are not able to claim an exemption for more limited filings due to an intent to change or influence control of the issuer.

Discounted cash flow (DCF) is a valuation method used to estimate the attractiveness of an investment opportunity. DCF analysis uses future free cash flow projections and discounts them to arrive at a present value estimate, which is used to evaluate the potential for investment.

As of March 31, 2021, the top ten holdings for the Longleaf Partners Small-Cap Fund: Lumen, 12.7%; Realogy, 6.5%; CNX Resources, 6.4%; Mattel, 6.2%; Empire State Realty, 5.7%; Lazard, 4.6%; Graham Holdings, 4.6%.; Eastman Kodak, 4.5%, LANXESS 4.3% and Hyatt Hotels, 4.1%. Fund holdings are subject to change and holding discussions are not recommendations to buy or sell any security. Current and future holdings are subject to risk.

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